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ICI to SEC: Expand Rater Rules

Also Wants More Secondary Disclosure

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By [Andrew Ackerman](#)

WASHINGTON - The Investment Company Institute yesterday urged the Securities and Exchange Commission to both expand its proposed credit rating agency rules on structured products to municipal securities and to increase the secondary market disclosure requirements for the municipal market.

According to ICI, the SEC's proposed rules that would require credit rating agencies to disclose conflicts of interest highlight similar disclosure issues in the municipal market. In addition, the commission's proposal to take references to certain ratings out of its rules will put the onus of credit analysis more squarely on fund companies and other investors that will in turn need more up-to-date disclosures from municipal issuers.

The ICI made its pleas in a [20-page comment letter](#) sent to the SEC on the proposed rules that was signed by its general counsel Karrie McMillan. The letter, which argued that muni disclosure is often stale, was filed with the SEC Friday and was posted on ICI's Website yesterday.

"It's very difficult to do analysis if you don't have the full amount of information," McMillan, said in an interview yesterday.

At the same time, California Treasurer Bill Lockyer also asked the SEC to consider expanding its credit rating rule proposals, which aim to enhance the transparency and disclosures of ratings for structured finance products, so that they encompass ratings for corporate and municipal securities, as well.

"In my view, the commission's intent is laudable, but the regulations do not go far enough," Lockyer wrote in a [five-page comment letter](#) made public yesterday. "I believe the commission should expand the proposed rulemaking in nearly every instance to include all classes of credit ratings."

Both letters come about a month after the SEC proposed three sets of proposed rules that seek to limit the influence of credit rating agencies and boost the role of analysts at investment firms. The rules also aim to limit rating agencies' conflicts of interest, increase their disclosures, and better differentiate between structured, corporate or municipal securities by requiring them to attach symbols or a lengthy report to their structured ratings.

Comments on the first two sets of proposals - on conflicts of interest and disclosure - were officially due Friday.

In its letter, ICI asked the SEC to improve municipal disclosure by modifying the list of 11 types of material events under the SEC's Rule 15c2-12 "to more fully reflect the types of events that are

material to today's investors." Some of the changes the group would like to see include required disclosure of "material" litigation or regulatory action - pending or threatened - as well as any failure to meet any financial covenants contained in bond documents, especially the failure to make any monthly or quarterly payments due under the terms of the documents.

ICI said that enhancements to 15c2-12 are necessary because existing disclosure regime is "limited, non-standardized and often stale" and that "the disparities from the corporate issuer disclosure regime are numerous."

The muni disclosure changes, ICI said, should be considered separate from a draft rule that the commission is expected to take up tomorrow that will propose replacing the four existing nationally recognized municipal securities information repositories, or NRMSIRs, with the Municipal Securities Rulemaking Board's Electronic Municipal Market Access, or EMMA, system, which the investment group also supports.

The ICI letter tied the disclosure problems in the municipal market to the 1975 Tower amendment, which restricts the MSRB and the SEC from directly or indirectly requiring muni issuers to file documents with them before the securities are sold. ICI said the Tower amendments should be repealed and that, barring such a repeal, the SEC should work to modify 15c2-12 to improve a disclosure regime that is "woefully inadequate."

Mirroring the muni initiatives unveiled last summer by SEC chairman Christopher Cox, ICI also urged Congress to clarify the legal responsibilities of officials of multiple issuers for the disclosure documents that they authorize. Congress should spell out the responsibilities of underwriters with respect to the offering statements in municipal offerings and the legal responsibilities of bond counsel and other participants, ICI said. Congress should also consider imposing certain disclosure requirements directly on municipal issuers, the group said.

The ICI letter comes as Congress is considering legislation that would require credit rating agencies to rate municipal bonds on the same scale as corporate and other debt, based on the likelihood of repayment alone. The bill, which was introduced by House Financial Services Committee chairman Barney Frank, D-Mass., is set to be voted on by the committee tomorrow. Currently, munis are rated separately from other securities.

ICI questioned the practicalities, benefits and timing of merging the rating scales, given the significant differences between the issuers of different types of securities. Despite a single scale, many market participants such as institutional investors will continue to differentiate between issuer while less-sophisticated investors may become more confused.

"If you treat municipals the same as corporate securities for credit rating purposes, you should treat them the same for disclosure," McMillan said in the interview.

Tom Dresslar, a spokesman for Lockyer, who has led a high-profile campaign to overhaul the current system used by rating agencies, said yesterday that there's no demonstrated need to repeal Tower and that doing so would be tantamount to using "a shotgun aimed at a flea."

"The global scale and disclosure issues are separate," he said. "A uniform rating system should be decided on its own merits and not linked to ancillary issues like disclosure," stressing that defaults on general obligation municipal debt are practically non-existent. He added that ICI's plan would heap undue issuance costs on taxpayers who already are saddled with burden caused by the "unfair double-standard rating system."

In his letter, Lockyer lauded several aspects of the SEC's rating agency proposals, including a restriction on agencies from helping to structure deals they rate. Such inherent conflicts between the rating

agency's business interests and the ratings process exist regardless of the class of the security, he said.

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